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C O N F I D E N T I A L SECTION 01 OF 05 MEXICO 000939

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TAGS: OVIP ECON MX
SUBJECT: KEY ECONOMIC THEMES FOR THE MARCH VISIT OF
PRESIDENT BUSH

MEXICO 00000939 001.3 OF 005

Classified By: AMBASSADOR ANTONIO O. GARZA, JR., REASONS: 1.4(B/D).

Summary

¶1. (C) The President,s visit comes at critical time as the new Mexican government seeks to set and implement its priorities across many fields. Our common border with Mexico gives us strong common interests, including security and North American economic success. The United States has a great stake in what Mexico can accomplish in the next few years. Our key economic aim in 2007 is to encourage, in a quiet way, needed Mexican actions in vital areas such as reducing barriers to legitimate trade across our common border, deregulation, energy reforms, professionalization of government, education, anti-poverty efforts and job creation. Mexican leaders generally understand what needs to be done, but are often blocked by internal political and vested interest gridlock. Sharing best practices, helping set the Mexican policy stage for needed actions, and technical assistance will be useful actions that we can take. It is also important to maximize private sector interest in undertaking the reforms needed to make Mexico competitive in the global economic market. We should highlight that annual U.S.-Mexico trade is set to exceed USD 375 billion in 2007. End Summary.

The Border - Ensuring Security and Prosperity

¶2. (C) The U.S.-Mexico border presents an enormous set of critical challenges for both countries, ranging from the immigration reform debate in the U.S., the flow of illegal migrants, insecurity and lawlessness in the Mexican border regions, trafficking in narcotics and other types of contraband smuggling. We are rightly focused on the many criminal activities prevalent at the border and the need to reduce their impact on the U.S. We should continue to encourage the marked progress we have seen in recent years in U.S.-Mexico cooperation against terrorism, counter-narcotics operations and extraditions.

¶3. (C) Our common border poses an equally great economic challenge. Total trade in goods between the U.S. and Mexico is now in excess of USD 330 billion annually. We also traded more than USD 36 billion worth of services in 2005, the most recent year for which we have numbers. U.S.-Mexico trade is growing rapidly, almost 15 percent between 2005 and 2006. Based on conversations with senior Mexican officials, we expect President Calderon will raise facilitation of legal trade as a priority in the March Summit.

¶4. (U) Numerous North American studies and trade groups have stressed that border facilities and procedures must be improved significantly to accommodate present trade and expected future growth. In their February 2007 report to the Security and Prosperity (SPP) Ministerial, the North American Competitiveness Council declared their first priority to be, "improving the secure flow of goods and people within North America." In this context, it is important to remember that trade facilitation does not come at the expense of security.

¶5. (C) Commerce Assistant Secretary David Bohigian heard this message loud and clear in his two recent visits to the border region. His visit helped refine and expand a list of short-term fixes at a number of key border points in order to shorten waiting times while assuring border security. In some cases, this means extending and/or synchronizing operating hours at U.S. and Mexican facilities at the same border crossing, and ensuring that industry takes advantage of this opportunity. In other cases, it means sharing best practices and reducing duplicative inspections. It also means employing new technologies to track and speed the secure movement of cargo. It includes identifying critical infrastructure investments needed on both sides of the border. Finally, it involves the private sector to make the North American supply chain more secure and efficient. Commerce Secretary Gutierrez and Mexican Economy Secretary Sojo stressed the importance of bilateral trade and making the border as efficient as possible in their February meetings in Mexico and Ottawa.

Recommendation

¶6. (C) The key to concrete bilateral progress in 2007 in ensuring security while reducing barriers to legitimate trade across the border will be engagement by senior U.S. and

Mexican officials, including White House/Presidencia, DHS, Commerce, DOT and their respective Mexican counterparts. A first step could be the creation of a senior U.S./Mexican working group with decision-making authority that could report to the Presidents at the next SPP leaders meeting with a specific work plan that lays out a strategic approach to solving specific border crossing issues. Empowering U.S. and Mexican border personnel with best practices, additional resources, new technology, and adequate infrastructure will enhance their ability to ensure that commercial vehicles entering the United States do not pose a threat to national security -- while protecting North America's competitive advantage versus economic powerhouses outside our region.

Mexico's Overall Economy

¶7. (C) Mexico,s senior economic officials are top-notch across the board. Most have Ph.Ds from leading U.S. universities and a keen sense of the nation's economic strengths and weaknesses. They can take justifiable pride in the very positive rating Mexico now enjoys in world financial markets, including the enthusiastic response of investors when Mexico became the first country in Latin America to issue a 30-year bond denominated in the local currency. They do not need macroeconomic advice.

¶8. (C) Mexico,s most pressing public policy problem is that

the government relies on oil-related revenues for 37% of the federal budget, and states and municipalities rely on funds from the federal government for nearly all their revenues. In Latin America, only Guatemala has a lower tax collection rate than Mexico. Finance Minister Agustin Carstens has said publicly that Mexico needs to implement a broad fiscal reform to improve tax collection, reduce over reliance on oil income, confront growing pension liabilities and rising payments on government borrowing outside the federal budget, and meet growing needs for spending on poverty alleviation, education, health and other social programs.

¶9. (C) Because of these challenges, the government will focus its fiscal reform efforts over the next few years on increasing tax collection, reducing tax evasion, making government spending more efficient, and lowering the country's dependence on oil revenues. Carstens has already asked for U.S. technical assistance and training that would allow the Mexican government to build a better tax service, professionalize Mexican Customs, and develop better analytical capabilities to combat money laundering, terrorist financing and related areas.

Recommendation

¶10. (C) Talks on the provision of such assistance by Treasury, DHS, and others are progressing well. It will be important to assure President Calderon that the U.S. is committed to doing its utmost to provide these types of training and technical assistance as desired by Mexico.

Mexico,s Global Competitiveness

¶11. (C) Mexico,s leaders are keenly aware of the need to stop Mexico,s declining global competitiveness. Moreover, most agree on what needs to be done: reform the labor code; encourage competition in major sectors dominated by only a few firms; reform the fiscal regime; attract new investment; fix a deficient education system; provide opportunities to talented people across Mexico; and improve respect for rule of law, including intellectual property rights. By any measure, the challenges are daunting, and entail taking on entrenched interests.

¶12. (C) Just three months into their term, Calderon and his team are still setting overarching economic priorities. As Finance Minister Carstens and Economy Minister Sojo recently told the Ambassador, Calderon is serious about taking on the monopolies and labor unions, but they are strong enemies and the GOM needs to navigate carefully this political mine field.

Recommendation

¶13. (C) We should emphasize our common stake in Mexico,s overall economic success and the nation's ability to improve its competitiveness across the board. In broad terms, we

should encourage implementation of needed reforms and ask Calderon how we can help. Based on conversations here, we should not expect GOM requests for massive aid for economic development, but instead interest in sharing best practices across a range of fields: education; poverty alleviation; technical training; anti-trust regulation, etc. We should be ready with concrete ideas. Examples are small high-level exchanges on globalization challenges along the lines of the September 2006 North American Forum convened by George Shultz or even more targeted sector-specific sessions (wired classroom, adult vocational training, microfinance options, etc.) between Mexican policy makers and top U.S. business, foundation, and academic officials.

Energy

¶14. (C) After Canada, Mexico is the largest source of U.S. oil imports. The United States has a strong strategic interest in continued stable supplies of energy from our southern neighbor. Within Mexico, energy is an extremely sensitive political and even emotional topic tied historically to national sovereignty. That said, Mexico,s energy sector requires difficult reforms soon and the outcome of Mexican government decisions (or lack thereof) will have a significant effect on future oil production as well as Mexico,s budget picture. Due to the current constitutional prohibition against private investment in many areas of the energy sector, the government must provide the tens of billions of dollars that Pemex (the state oil monopoly) needs in energy investments over the coming decade. Booming oil revenues have largely been squandered on subsidizing electricity, gasoline, and natural gas consumption. Luckily, oil revenues have been high enough to keep public finances healthy for the time being. However, the current system, which spends rather than saves excess oil revenues, will not withstand a major drop in oil prices or production over the next few years (which is close to inevitable if current restrictions remain in place).

¶15. (C) As our second largest crude supplier, what Mexico does or does not do to maintain production will have a major impact on North American energy supply and security for at least the next ten years. We have largely avoided any direct discussions over energy because of its sensitivity in Mexican politics. President Calderon, a former Energy Secretary, is looking at how best to maintain production and invest in this critical sector.

Recommendation #1

¶16. (C) The March meeting would be a good opportunity to underscore our common interest in North American energy security and supply. Adopting a recommendation of the North American Competitiveness Council (NACC), it would be useful to propose preparation of a joint North American (U.S./Mexico/Canada) energy outlook with a 25 year time horizon. The idea would be to focus on the broad and complex dynamics of the sector, especially in terms of exploration, investment, planning cycles and secure supplies for the region. Assuming Canada also agrees, the project could be announced by the three leaders in Canada in August as a deliverable for their presumed meeting in mid-2008. Preparation of the report in Mexico during 2007-08 (perhaps by an elite university) would spur needed energy reform policy discussions and could fit well with informal GOM comments that the Calderon administration will tackle energy issues more robustly in 2008-9.

Recommendation #2

¶17. (C) In terms of a short-term actions (and linked to a separate NACC recommendation), the President could ask if Calderon would support the idea of a Gulf of Mexico Governors, meeting (or a more general energy states meeting to include Alaska and 2-3 Canadian provinces) to discuss the role of sub-federal entities in energy planning for the longer-term (development, financing issues, infrastructure, environment, etc.). This could prove too sensitive for the GOM at this point, but might be another trilateral way to promote dialogue on the importance of energy supplies and revenues.

Recommendation #3

¶18. (C) The President could also propose to Calderon implementing the terms of the 2000 Western Gap Treaty between the U.S. and Mexico. This could include forming a working group of scientists and engineers to exchange geological and geophysical information from both sides of the border to define and delimit transboundary reservoirs. The groups could also discuss models for the equitable development of transboundary reservoirs as set out in the 2000 Treaty. U.S. officials worked to this end unsuccessfully during the Fox Administration, but cooperation in this area could be an excellent opportunity to begin speaking practically with Mexican officials about shared energy goals in the Gulf of Mexico.

NAFTA and Trade Policy Topics

¶19. (C) According to Mexican Economy Minister Sojo and senior Mexican trade officials, the Calderon Administration believes that many of NAFTA,s provisions need to be updated, and want North American political leaders to consider re-opening chapters that deal with market access, rules of origin, and customs treatment. We have highlighted the domestic U.S. political dangers of this approach. We have urged the GOM to proceed cautiously given the U.S debate this spring about trade promotion authority renewal, expected opposition from vested interest groups with strong lobbies in Washington, and internal Mexican demands that NAFTA agricultural provisions be renegotiated to stop the planned January 1, 2008 opening of corn and bean markets here. That said, there is still a good chance that President Calderon will make a case for moving more quickly on such North American integration topics. Separately, Mexico has been a steady partner in the world effort to restart the stalled Doha round of world trade talks.

Recommendation # 1

¶20. (C) One way to respond to Mexican requests on updating NAFTA would be to suggest a senior working group on trade topics that will focus, in the first instance, on areas for improvement in a broad array of technical issues (rules of origin, cumulation, regulatory harmonization, customs rules). These would be NAFTA trade-facilitating fixes that would not require new legislation. We could postpone consideration of other options until we have a clearer picture of how Capitol Hill intends to deal with trade issues later in 2007.

Recommendation #2

¶21. (C) On agricultural issues, we can say that the U.S. wants to work with Mexico on technical ways to help the transition in sensitive agricultural sectors. The Consultative Committee on Agriculture could offer a venue here. We should also draw from the results on Secretary Johanns, March 5-6 Mexico visit for possible additional approaches.

Recommendation #3

¶22. (C) We should thank Calderon for Mexico,s consistent support of U.S. and other efforts to restart the Doha round. We should also encourage Mexico to play a stronger role in this regard.

Intellectual Property Rights (IPR)

¶23. (C) Over the past several years, Mexico,s federal IPR agencies have ratcheted up the numbers of raids, arrests, and seizures against commercial piracy and counterfeiting operations. Unfortunately, these efforts remain stymied by lack of resources, outdated legislation, a judicial system that makes it difficult to obtain convictions and jail-time for violators, lack of cooperation from state and municipal

governments, and a broad cultural acceptance of illegal commerce. As a result, U.S. (and Mexican) companies continue to lose hundreds of millions of dollars each year to the increasingly well-organized criminal gangs that run this sprawling illicit business. The new Calderon administration has initially focused its law enforcement energies on high-profile campaigns to combat narco-traffickers, but business groups are lobbying for stronger IPR enforcement as well, particularly given Calderon,s commitment to improving Mexico,s investment climate.

Recommendation

¶24. (C) President Bush could remind Calderon that Mexico will have a hard time attracting investment from high value added creative industries unless it is able to control rampant piracy and counterfeiting, and emphasize that we want to continue working with Mexico both bilaterally and via the Security and Prosperity Partnership to strengthen protection of intellectual property rights.

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